INDEX

	Page
OPINIONS BELOW	1
JURISDICTION	1
QUESTIONS PRESENTED	2
STATEMENT OF THE CASE	2
ARGUMENT	4
I. THE COURT OF APPEALS WAS CORRECT IN HOLDING THAT THE CASE SHOULD HAVE GONE TO THE JURY ON THE ISSUE OF LIABILITY UNDER RULE 10b-5	4
A. The Relationship Between The Parties	4
B. Fraud and Deception Under The Federal Securities Laws	5
C. The Liability of Hentz	7
II. THE COURT OF APPEALS WAS CORRECT IN HOLDING THAT THE ISSUES OF NEGLIGENCE, NEGLIGENT MISREPRESENTATIONS, VIOLATIONS OF RULE 405, AND VIOLATIONS OF THE FLORIDA STATUTES SHOULD HAVE GONE TO THE JURY	8
A. Negligence	8
B. Negligent Misrepresentations	8
C. Rule 405	9
D. Liability Under the Florida Acts	9

INDEX (cont.)

Page

III. THE COURT HAD JURISDICTION OF CLAIMS ARISING UNDER STATE LAW UNDER PENDENT JURISDICTION 10

CONCLUSION 11

CERTIFICATE OF SERVICE 12

APPENDIX

TABLE OF CITATIONS

Case	Page
Affiliated Ute Citizens v. United States, 406 U.S. 128, 31 L.Ed.2d 741 (1972)	5, 6
Bobby Jones Garden Apartments, Inc. v. Suleski, 391 F.2d 172 (5th Cir. 1968)	8
Boeing Company v. Shipman, 411 F.2d 365 (5th Cir. 1969)	4
Buttrey v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135 (7th Cir. 1969) cert. den. 396 U.S. 838	9
Herpich v. Wallace, 430 F.2d 792 (5th Cir. 1970)	7
Hurn v. Oursler, 289 U.S. 238, 77 L.Ed. 1148 (1932)	10
Joiner v. McCullers, 28 So.2d 823 (Fla. 1947)	8
Kutner v. Kalish, 173 So.2d 763 (Fla. Dist. Ct. App. 1965)	8
Lorentz v. Watson, 258 F.Supp 724 (E.D. Pa. 1966)	7
Reynolds & Co., et al., 39 S.E.C. 902 (1960)	7

TABLE OF CITATIONS (cont.)

Case	Page
Securities & Exchange Commission v. Capital Gains Research Bureau, 375 U.S. 180, 84 S.Ct. 275, 11 L.Ed. 2d 237 (1963)	5
S.E.C. v. Texas Gulf Sulfur Co., 401 F.2d 833 (2d Cir. 1968)	7
Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed. 2d 128 (1971)	5, 6
Watson v. Jones, 25 So. 823 (1899)	8
Wheeler v. Baars, 16 So. 584 (Fla. 1894)	8

STATUTES AND REGULATIONS CITED

15 U.S.C. §78(j) (Securities Exchange Commission Rule 10b-5)	9
15 U.S.C. §78(t)	7
15 U.S.C. §78(bb)	9
Florida Statutes §517.301	9

in the

Supreme Court

of the

United States

OCTOBER TERM, 1972

No. 72-1533

H. HENTZ & CO. and RALPH NERNBERG,
Petitioners,

vs.

DAVID KASNER and JOAN KASNER,
Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

(Appendix contained herein)

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 475 F.2d 119 (5th Cir., 1973) and is included herein in the Appendix. (*Infra* A.1)

JURISDICTION

The judgment of the Court of Appeals was entered on March 15, 1973. Rehearing was denied on April 4, 1973. The petition for a writ of certiorari was filed on or about May 14, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

I

WAS THE COURT OF APPEALS CORRECT IN HOLDING THAT THE CASE SHOULD HAVE GONE TO THE JURY ON THE ISSUE OF LIABILITY UNDER RULE 10b-5?

II

WAS THE COURT OF APPEALS CORRECT IN HOLDING THAT THE CASE SHOULD HAVE GONE TO THE JURY ON THE ISSUES OF NEGLIGENCE, NEGLIGENT MISREPRESENTATIONS, RULE 405, AND VIOLATIONS OF THE FLORIDA STATUTES?

III

DID THE COURT HAVE JURISDICTION OF CLAIMS ARISING UNDER STATE LAW UNDER PENDENT JURISDICTION?

STATEMENT OF THE CASE

In September of 1969, the defendant brokerage house H. Hentz & Company by and through its registered representative Ralph Nernberg talked the plaintiffs David and Joan Kasner, his wife, customers of the defendants, out of leaving the stock market and into giving defendant Nernberg discretionary authority over their account by telling the plaintiffs that Nernberg could "turn the account around" and make back in two years all the plaintiffs had previously lost in the market. (R.113-116, 118, 148-149, 175, 187-189). When the plaintiffs succumbed to this solicitation and misrepresentation by Nernberg in Sep-

tember of 1969, the account had an equity value of $53,000. Seven short months later in May of 1970, when Hentz and Nernberg surrendered the discretionary authority and returned what was left of the account to the plaintiffs, only $3,000 remained. (R.131-133 Plaintiffs' Exhibit No. 7A). The plaintiffs then brought this action against Hentz and Ralph Nernberg under Section 10 of the Securities Exchange Act of 1934 and Regulation 10b-5 of the Securities Exchange Commission issued thereunder, Rule 405 of the New York Stock Exchange Rules, the Florida Statutes and for negligence. The case of the plaintiffs essentially rested on the theories that defendants Nernberg and Hentz talked them out of leaving the market and into giving defendant Nernberg discretionary authority over their account by misrepresentation and material non-disclosure; and that defendants had breached their fiduciary obligations to the plaintiffs by recklessly subjecting the plaintiffs to undue risk of margin calls on market drops without disclosing this to the plaintiffs, finally resulting in a forced sell-off of the bulk of the plaintiffs' securities at sacrifice prices. The plaintiffs also showed negligent supervision of Nernberg by Hentz since this special type account was never given the close watching Hentz admitted was called for. (R.46, 57, 204-207, 209-211).

Although the plaintiffs proved each and every fact in the complaint, the trial court nevertheless directed a verdict at the end of the plaintiffs' case and took the case away from the jury.

The plaintiffs appealed and the Court of Appeals for the Fifth Circuit reversed and remanded the case for trial, 475 F.2d 121 (5th Cir. 1973). The defendants then moved for a rehearing which was denied.

ARGUMENT

I.

THE COURT OF APPEALS WAS CORRECT IN HOLDING THAT THE CASE SHOULD HAVE GONE TO THE JURY ON THE ISSUE OF LIABILITY UNDER RULE 10b-5.

In this case the Court of Appeals, on the authority of *Boeing Company v. Shipman,* 411 F.2d 365 (5th Cir. 1969) reversed the trial judge because he directed a verdict in a case which had jury questions. The defendants' attempt to create conflicts in Circuits is misplaced in this case where a reversal was granted because a trial judge took away a jury's right to determine questions which should have properly been submitted to them.

A. The Relationship Between The Parties

The defendants do not contest three important facts in the Petition. Firstly, Nernberg and Hentz had discretionary authority in the Kasner account in September of 1969. As a Vice President of Hentz admitted, a discretionary account means that a customer turns over his account to the registered representative (here Nernberg) and tells him "Handle the account for me; watch it for me." (R.45, 102). Secondly, once the defendants took discretionary authority in the Kasners' account, they owed the Kasners a much higher duty than they would have in a normal account (R. 46, 57, 64-65, 210, 211, 299); and, thirdly, the discretionary account created a fiduciary relationship between the parties.

B. Fraud and Deception Under The Federal Securities Laws

Defendants in their Petition would like to revert to restrictive and narrow common law definitions of "fraud" and apply these definitions to the Securities laws. Such a step-back in the law is not warranted.

The breadth of the concept of fraud and deception under Rule 10b-5 of the Securities Act is demonstrated by the case of *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 31 L.Ed. 2d 741, 760 (1972) wherein this court stated that the proscriptions of this Rule (10b-5):

> "are broad and by repeated use of the word 'any' are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments embrace a 'fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.' *Securities & Exchange Commission v. Capital Gains Research Bureau,* 375 US 180, 186, 11 L Ed 2d 237, 243, 84 S. Ct. 275 (1963). In the case just cited the Court noted that Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed 'not technically and restrictively, but flexibly to effecuate its remedial purposes.' Id., at 11 L Ed. 2d at 248. This was recently said once again in *Superintendent of Insurance v. Bankers Life & Casualty Co.,* 404 US 6, 30 L.Ed. 2d 128, 92 S.Ct. 165 (1971.)"

Section 10b-5 also applies to breaches of a fiduciary relationship, (as exists here) for this Court held in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed. 2d 128, 133-134 (1971) that for conduct that constitutes a "disregard of trust relationships by those whom the law should regard as fiduciaries . . . there is redress under §10(b) . . . ."

Defendants by their own admission had a duty to disclose to plaintiffs the status and severe jeopardy in their account, and to watch the account and supervise it (R. 46, 57, 64-65, 209-211). Yet, defendants nowhere in their Petition allege that they ever informed the Kasners of the maintenance level in their account, or the jeopardy that defendants had created in the account. Nor do the defendants contest plaintiffs' claim of lack of supervision by Hentz over this discretionary account.

This court also held in the *Affiliated Ute Citizens* case, *supra*, 31 L.Ed. 2d at 761-762 that where one has a duty under Rule 10b-5 to disclose material information, "positive proof of reliance is not a prerequisite to recovery." The Court said that if the facts withheld are material, then the obligation to disclose them, coupled with the actual omission, establish the requisite element of causation in fact.

It cannot be seriously contended that failing to disclose to the Kasners the status of their account and the severe jeopardy it was in was not material. (R. 123-124, 176-177, 187-189).

When the nondisclosures are coupled with Nernberg's misrepresentations and Hentz's lack of supervision, the conduct of defendants clearly amounted to a fraudulent or deceptive course of business contrary to the stated purposes of Rule 10b-5 which are "to protect the investing public and to secure fair dealing in the securities market". *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970), *S.E.C. v. Texas Gulf Sulfur Co.*, 401 F.2d 833 (2d Cir. 1968).

C. The Liability of Hentz

Firstly, Hentz has never disputed that Nernberg was their agent so that if he is liable — they are liable. Secondly, defendant Hentz is liable as a controlling person as defined in Section 20 of the Act (15 U.S.C. §78[t]).

The case of *Lorentz v. Watson*, 258 F.Supp. 724, 733 (E.D. Pa. 1966) discusses the liability of controlling persons and cites from the case of *Reynolds & Co., et al.*, 39 S.E.C. 902 (1960) wherein the Commission pointed out that when a securities firm fails to properly supervise and watch out for the interests of its customers so as to prevent misconduct in the handling of the accounts of such customers, the brokerage house is equally liable, and such failure is sufficient to give rise to liability under Rule 10b-5. Hentz's failure in this case to supervise its agent in this discretionary account, and to watch it as they admit they had a duty to do, establishes their liability — or at the very least presents a jury question.

II.

THE COURT OF APPEALS WAS CORRECT IN HOLDING THAT THE ISSUES OF NEGLIGENCE, NEGLIGENT MISREPRESENTATIONS, VIOLATIONS OF RULE 405, AND VIOLATIONS OF THE FLORIDA STATUTES SHOULD HAVE GONE TO THE JURY.

A. Negligence

Plaintiffs charged the defendants with negligent supervision over the account, negligent management of the account and negligent misrepresentations. It is obvious that these questions were at issue in the case since defendants pleaded and argued affirmative defenses such as contributory negligence and assumption of the risk (R. 30-31), and the Court directed a verdict on the questions of negligence. (R. 270-271)

The question of common law negligence was certainly a jury question, and the Fifth Circuit in reversing the trial judge in this case, so held.

B. Negligent Misrepresentations

Under the law of Florida, negligent misstatements are sufficient to establish liability. This was pointed out by the Fifth Circuit in *Bobby Jones Garden Apartments, Inc. v. Suleski*, 391 F.2d 172, 177-178 (5th Cir. 1968) citing the Florida cases of *Kutner v. Kalish*, 173 So.2d 763 (Fla. Dist. Ct. App. 1965); *Joiner v. McCullers*, 28 So.2d 823 (Fla. 1947); *Watson v. Jones*, 25 So. 823 (1899) and *Wheeler v. Baars*, 16 So. 584 (Fla. 1894). Again a jury question.

C. Rule 405

The case of *Buttrey v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir. 1969) *cert. den.* 396 U.S. 838, is a direct authority for an implied right of action based on violation of a "self-regulatory rule." It is undisputed that defendant Hentz is a member of the New York Stock Exchange. The claim in *Buttrey*, as in the case at Bar, was based on an allegation that the broker-dealer violated New York Stock Exchange Rule 405, the "know your customer rule." As the Court said in the *Buttrey* case at page 142:

> "The touchstone for determining whether or not the violation of a particular rule is actionable should properly depend on its design 'for the direct protection of investors' . . . Here one of the functions of Rule 405 is to protect the public, so that permitting a private action for its violation is entirely consistent with the purposes of the statute."

Such a possible violation was likewise properly held to be a jury question in the instant case.

D. Liability Under the Florida Acts

The plaintiffs were customers of the Coral Gables, Florida office of defendant Hentz. The cause of action clearly arose in Florida. Petitioners pre-emption argument is absurd.

Section 78(bb) of the 1934 Act specifically reserves the right to the states to have their own Securities laws. Section 517.301 of the Florida Statutes merely traces the language of Rule 10b-5. Had Congress intended to pre-empt the field in the area of Securities law it would have said so.

The conduct of defendants in the instant case clearly presented jury questions on a possible violation of the Florida Statutes. The Circuit Court so held in reversing the trial court and it is respectfully submitted was correct in so doing.

III.

THE COURT HAD JURISDICTION OF CLAIMS ARISING UNDER STATE LAW UNDER PENDENT JURISDICTION.

The defendants also claim in their Petition that the Court lacked jurisdiction to decide any issues under state law because there was not complete diversity between the parties.

In the Complaint, plaintiffs claimed jurisdiction of causes of action arising under state law under the doctrine of pendent jurisdiction.

It is well established law that where there are two distinct grounds in support of a single cause of action and only one presents a Federal question, and the Federal question averred is not plainly wanting in substance, the Federal Court, even though the Federal ground is not established (which it is in our case), may, nevertheless, under the doctrine of pendent jurisdiction, retain and dispose of the case upon the non-Federal ground. *Hurn v. Oursler*, 289 U.S. 238, 77 L.Ed. 1148 (1932).

In this case there was a claim under the Federal Securities Laws. Thus, under the doctrine of pendent jurisdiction, the Court had jurisdiction over questions arising under state law.

CONCLUSION

The Court of Appeals was correct in holding that this case should have gone to the jury. The Petition for a writ of certiorari should be denied.

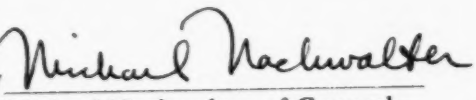
Respectfully submitted,

KELLY, BLACK, BLACK & KENNY, P.A.
1409 Alfred I. duPont Building
Miami, Florida 33131
(305) 373-5584
Attorneys for Respondents

By Michael Nachwalter
Michael Nachwalter

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that three copies of the foregoing Brief for Respondents in Opposition to Petition for a Writ of Certiorari and Appendix annexed thereto were served upon Sidney M. Aronovitz, Esquire, of Aronovitz, Silver & Booth, 908 Ainsley Building, Miami, Florida 33132, counsel for H. Hentz & Co. and Ralph Nernberg, by depositing same in a United States mail box with first class postage prepaid, addressed accordingly, and in accordance with Rule 33, Supreme Court Rules, this 12th day of June, 1973.

By 

Michael Nachwalter, of Counsel
Kelly, Black, Black & Kenny, P.A.
1409 Alfred I. duPont Building
Miami, Florida 33131
Attorneys for Respondents

APPENDIX

APPENDIX

475 F.2d 119 (1973)

David KASNER and Joan Kasner,
Plaintiffs-Appellants,

v.

H. HENTZ & CO. and Ralph Nernberg,
Defendants-Appellees.

No. 72-1575.

United States Court of Appeals,
Fifth Circuit.
March 15, 1973.

Rehearing Denied April 4, 1973.

Action by customers against broker and its registered agent to recover for damage allegedly occasioned by agent's false dealings and breach of trust in handling plaintiffs' discretionary stock account. The United States District Court for the Southern District of Florida, Emett C. Choate, J., directed verdict for defendants and plaintiffs appealed. The Court of Appeals, Ingraham, Circuit Judge, held that whether agent had made false statements, whether they were material and whether customers had been justified in their reliance thereon were questions for trier of fact.

Reversed and remanded.

1. Courts

Where jurisdiction was found under Securities Act of 1933 and Securities Exchange Act of 1934, pendent jurisdiction over plaintiffs' counts alleging state securities law violations and common-law negligence was also present in case in which gravamen of complaint was that broker's registered agent had induced plaintiffs to give him trading authority over their stock portfolio and that nine months later their equity had been reduced from in excess of $50,000 to about $3,000. F.S.A. § 517.301; 28 U.S.C.A. §§ 1331, 1337; Securities Act of 1933, § 22(a), 15 U.S.C.A. § 77v(a); Securities Exchange Act of 1934, §§ 10, 15(c)(1, 2), 15 U.S.C.A. §§ 78j, 78o(c)(1, 2).

2. Brokers

In action by customers against broker and its registered agent for damage allegedly occasioned by agent's false dealings and breach of trust in handling customers' discretionary stock account, whether agent had made false statements, whether they were material and whether customers were justified in their reliance thereon were questions for trier of fact; thus the district court should not have granted directed verdict for defendants. F.S.A. § 517.301; Securities Act of 1933, § 22(a), 15 U.S.C.A. § 77v(a); Securities Exchange Act of 1934, §§ 10, 15(c)(1, 2), 27, 15 U.S.C.A. §§ 78j, 78o(c)(1, 2), 78aa.

Michael Nachwalter, Miami, Fla., for plaintiffs-appellants.

Sidney M. Aronovitz, Miami, Fla., for defendants-appellees.

Before BROWN, Chief Judge, and TUTTLE and INGRAHAM, Circuit Judges.

INGRAHAM, Circuit Judge:

Plaintiffs-appellants, customers of H. Hentz & Co., a brokerage firm, brought suit against the firm and Ralph Nernberg, its registered agent, to recover damages allegedly occasioned by Nernberg's false dealings and breach of trust in handling plaintiffs' discretionary stock account. More particularly, plaintiffs sought damages from Nernberg and Hentz on three theories: (1) violations of 15 U.S.C. § 78j, 15 U.S.C. § 78o(c)(1)-(2) and Securities Exchange Commission Rules 10b-5 and 15(c)(1)(2) promulgated thereunder; (2) negligent failure to properly supervise and administer a discretionary account in violation of New York Stock Exchange Rules 401 and 405 and (3) violations of the applicable securities laws, Florida Statutes Annotated § 517.301.

[1] Jurisdiction was asserted and is found under 28 U.S.C. §§ 1331 and 1337; § 22(a) of the Securities Act of 1933 [15 U.S.C. § 77v(a)], and § 27 of the Securities Exchange Act of 1934 [15 U.S.C.§ 78aa]. Pendent jurisdiction over plaintiffs' counts alleging state securities law violations and common law negligence is also present. McCurnin v. Kohlmeyer & Co. — F.2d — (5th Cir., 1973).

The gravamen of plaintiffs' complaint was that after suffering near disastrous losses in the stock market with a portfolio structured for a market decline, Dr. and Mrs. Kasner approached their broker Nernberg in September of 1969, intending to direct him to liquidate their holdings. Rather than lose an actively trading account and its attendant commissions, Nernberg, plaintiffs' allege, induced the Kasners to give him trading authority over their stock portfolio and to restructure it for a rising market. Plaintiffs testified that when they approached Nernberg to liquidate their holdings, he said to them:

> "And he said to me this would be [the] worst mistake you could make. Let me turn it around, and I'll make your money back in two years; and that he would be the manager of the account. He would take it off my hands, I wouldn't have to worry about it, I could go back to my doctoring, and I wouldn't have to look at these statements — I couldn't read anyway — No matter what they said, I couldn't read these statements; I didn't understand them. And so he offered me to take it over, he would manage it — he was an expert, a professional. I'd already learned that I could not handle the account any more; I was an amateur. I couldn't learn enough to handle this stuff. So — And here he was offering me to take it off my hands, take it over, make money back in two years.
>
> "I said, 'Fine, then take it over,' and that's essentially how he got the account."

In support of the Kasner's allegations that Nernberg had induced them to remain in the market with a disastrous result, plaintiffs introduced the discretionary authorization they had executed in Nernberg's favor in September of 1969. They also introduced evidence which showed that when signed over to Nernberg's discretion plaintiffs' portfolio, though below margin requirements, had a net equity in excess of $50,000. Less than nine months later, after active trading by Nernberg and maintenance calls, plaintiffs' equity in the account had been reduced to about $3000. Plaintiffs further showed that all transactions occurring in this period of time were initiated solely by defendant Nernberg under the supervision of Hentz & Co. and that plaintiffs had continued the account only at Nernberg's insistence.

In defense of the action Hentz relied on the testimony of Nernberg that he had not guaranteed results, nor that he had fraudulently or negligently managed the account. Defendants further relied on evidence that in the course of the decline in plaintiffs' equity, they had sent plaintiffs numerous notifications that their account was declining. The defense contended that given such knowledge plaintiffs could not justifiably have relied on Nernberg's management. At the close of the testimony on defendants' motion, the district court granted a directed verdict for the defendants.

[2] We reverse as jury questions on several controverted facts appear in this record. Boeing v. Shipman, 411 F.2d 365 (5th Cir., 1969), required that the case be submitted to the jury, the appropriate forum for determination of whether false statements were made, if so whether they were material, and if plaintiffs were justified in their

reliance thereon. Evans & Co. v. McAlpine, 434 F.2d 100 (5th Cir., 1970); Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876 (2nd Cir., 1972); Robinson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 377 F.Supp. 107 (N.D.Ala., 1971); Hecht v. Harris, Upham & Co., 283 F. Supp. 417 (N.D.Cal., 1968); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bocock, 247 F.Supp. 373 (S.D.Tex., 1965).

In arguments over the motion for directed verdict, plaintiffs suggested that the case already tried be sent to the jury which had heard it, then should the verdict be against defendants the court could properly consider a defense motion for a judgment n. o. v., which, should the court grant it and later be reversed, would obviate the need for a retrial. This suggestion was not followed and we consequently must remand this cause for re-trial.

The order of the district court is reversed and the cause remanded.